

Message Text

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PAGE 01 MANILA 18085 01 OF 03 160802Z

ACTION TRSE-00

INFO OCT-01 EA-10 ISO-00 NEA-10 IO-13 H-01 L-03 PRS-01

PA-01 AID-05 CIAE-00 COME-00 EB-08 FRB-03 INR-07

NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02 LAB-04

SIL-01 OMB-01 NSC-05 SS-15 STR-05 CEA-01 /108 W

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R 160659Z NOV 77

FM AMEMBASSY MANILA

TO SECSTATE WASHDC 7898

INFO AMEMBASSY JAKARTA

LIMITED OFFICIAL USE SECTION 1 OF 3 MANILA 18085

USADB

FOR NAC AGENCIES

E.O. 11652: NA

TAGS: EAID, EFIN, ID

SUBJECT: ADB PROPOSED LOAN -BANK PEMBANGUNAN INDONESIA
(BAPINDO) PROJECT

SUMMARY: ADB MANAGEMENT PROPOSING \$30 MILLION EQUIVALENT
AIOAN FROM ORDINARY CAPITAL RESOURCES TO REPUBLIC OF INDONESIA
TO MEET PART OF FOREX REQUIREMENTS OF BANK PEMBANGUNAN
INDONESIA (BAPINDO) DURING 1978-1980. LOAN WOULD BE USED
BY BAPINDO FOR FINANCING OF VIABLE DEVELOPMENT PROJECTS
BY MAKING SUBLOANS TO PRIVATE AND PUBLIC SECTOR ENTERPRISES.
BANK STAFF ASSERTS THAT EVEN THOUGH PROGRESS HAS BEEN
SLOW, BAPINDO IS BECOMING AN EFFECTIVE FINANCIAL INTER-
MEDIARY WITH SUFFICIENT AUTONOMY TO SELECT FINANCIALLY AND
ECONOMICALLY VIABLE SUB-PROJECTS. BANK STAFF ALSO ASSERTS
THAT THERE IS INSTITUTION BUILDING COMPONENT IN PROPOSED
LOAN, INDEPENDENT OF WORLD BANK'S ON-GOING PROGRAM TO
OVERCOME BAPINDO'S OPERATIONAL EFFICIENCIES. PROJECT IS
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PAGE 02 MANILA 18085 01 OF 03 160802Z

TECHNICALLY AND ECONOMICALLY ADEQUATE. RECOMMEND

FAVORABLE NAC ACTION WITH STATEMENT AT BOARD STATING
THAT ANY FUTURE ADB INVOLVEMENT WITH BAPINDO SHOULD BE
CONSIDERED IN LIGHT OF EXPECTED IMPROVEMENTS IN PER-
FORMANCE OF EXECUTING AGENCY. END SUMMARY.

1. ADB DOC. R114-77 WITH ATTACHMENTS DESCRIBING
PROPOSED LOAN POUCHED ADDRESSEES NOVEMBER 3. BOARD CON-
SIDERATION SCHEDULED NOVEMBER 24.

2. ADB MANAGEMENT PROPOSING \$30.0 MILLION EQUIVALENT
LOAN FROM ORDINARY CAPITAL RESOURCES TO REPUBLIC OF
INDONESIA TO MEET PART OF BAPINDO'S FOREZ REQUIREMENT
DURING 1978-1980. BULK OF SUB-LOANS WILL BE MADE IN
INDUSTRIAL SECTOR. PROPOSED TERHC ARE 15-YEAR AMORTINZATION
INCLUDING A THREE-YEAR GRACE PERIOD AT 8.3 PERCENT INTEREST.
GOVT WOULD RELEND TO BAPINDO AT 11 PERCENT. BAPINDO WOULD
THEN RELEND PROCEEDS AT 12 PERCENT PER ASSUN FOR SUBLOANS
UP TO \$240,964 EACH AND 15 PERCENT FOR SUBLOANS ABOVE
SAID AMOUNT. AMORTIZATION OF SUBLOANS WILL NOT
EXCEED 15 YEARS INCLUDING A THREE-YEAR GRACE PERIOD.
GOVT WILL ASSUME EXCHANGE RISK. INDONESIA TO BE BORROWER
AND BAPINDO TO BE EXECUTING AGENCY.

3. MANUFACTURING IN INDONESIA IS STILL IN EARLY STAGES
OF DEVELOPMENT AND, IN 1976, ACCOUNTED FOR ONLY 11.1 PERCENT
OF GDP DESPITE THE FACT THAT ITS AVERAGE GROWTH RATE IN
REAL TERMS DURING 1972-1976 WAS 12.6 PERCENT PER ANNUM.
IN 1973 ORGANIZED MANUFACTURING SECTOR EMPLOYED ABOUT
932,000 WORKERS IN SOME 27,000 ESTABLISHMENTS. IT IS
ESTIMATED THAT ALMOST TWICE THAT NUMBER OF WORKERS
WERE ENGAGED IN UNORGANIZED MANUFACTURING
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PAGE 03 MANILA 18085 01 OF 03 160802Z

SECTOR COMPRISING SMALL-SCALE AND HANDICRAFT INDUSTRIES.
INDUSTRIAL SECTOR CONSISTS MAINLY OF LIGHT CONSUMER GOODS
INDUSTRIES SUCH AS FOOD, BEVERAGE, TOBACCO, TEXTILE,
RUBBER AND PLASTIC PRODUCTS AND REPAIRS FOR MACHINERY
AND EQUIPMENT. FOOD AND TEXTILE INDUSTRIES ALONE ACCOUNTED
FOR ABOUT 73 PERCENT OF ORGANIZED LABOR FORCE AND TOTAL
VALUE ADDED IN MANUFACTURING SECTOR IN 1973.

4. CURRENT FIVE-YEAR DEVELOPMENT PLAN (REPELITA 11,
1974/75-1978/79) GIVES MUCH EMPHASIS TO DEVELOPMENT OF
LABOR-INTENSIVE SMALL AND MEDIUM-SIZE INDUSTRIES. LONG-
TERM OBJECTIVE OF GOVT'S INDUSTRIAL DEVELOPMENT POLICY
IS TO MOVE BY STAGES FROM EMPHASIS IN AGRO-PROCESSING
INDUSTRIES TO HEAVY AND BASIC INDUSTRIES. LATTER ARE
EXPECTED TO BE DEVELOPED DURING FOURTH PLAN (1984/85 -
1988/89,) BY WHICH TIME INDUSTRIAL SECTOR EXPECTED TO
REPLACE AGRICULTURE AS DOMINANT SECTOR. DURING PROCESS
OF TRANSFORMATION, INDUSTRIAL SECTOR IS TO PLAY IMPORTANT
ROLE IN GENERATING EMPLOYMENT, PRODUCING MASS
CONSUMPTION GOODS (E.G., FOOD, CLOTHING, BUILDING MATERIALS,
ETC.) AND IMPROVING FOREX POSITION. GOI ALSO AIMS AT
DIVERSIFYING INDUSTRIAL ACTIVITIES TO DIFFERENT REGIONS

OF COUNTRY AND PROMOTING PRIBUMI INDUSTRIES (INDUSTRIES WHERE ETHNIC INDONESIANS OWNS AT LEAST 75 PERCENT OF EQUITY).

5. TO ACHIEVE OBJECTIVES, GOI HAS OFFERED VARIOUS INDUCEMENTS AND ASSISTANCE TO PRIVATE SECTOR. FINANCIAL ASSISTANCE WAS PROVIDED BY MEDIUM TERM INVESTMENT CREDIT PROGRAM (INVESTASI) INTRODUCED IN 1969 TO PROVIDE SUBSIDIZED LOANS OF UP TO FIVE YEARS THROUGH STATE-OWNED BANKS AND REGIONAL DEVELOPMENT BANKS (RDBS) TO DOMESTIC INVESTORS IN ALL SECTORS. FROM FEBRUARY 1974, LOANS UNDER INVESTASI PROGRAM WERE CONFINED TO PRIBUMI INVESTORS. TO ASSIST SMALL INDUSTRIES, SMALL INVESTMENT

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PAGE 01 MANILA 18085 02 OF 03 160808Z
ACTION TRSE-00

INFO OCT-01 EA-10 ISO-00 NEA-10 IO-13 H-01 L-03 PRS-01
PA-01 AID-05 CIAE-00 COME-00 EB-08 FRB-03 INR-07
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INFO AMEMBASSY JAKARTA

LIMITED OFFICIAL USE SECTION 2 OF 3 MANILA 18085

USADB

FOR NAC AGENCIES

LOAN PROGRAM AND SMALL PERMANENT WORKING CAPITAL LOAN PROGRAM WERE INTRODUCED IN 1973 TO EXTEND CREDITS TO PRIBUMI ENTERPRISES UNDER SOFT TERMS. IN ADDITION, THE GOVT, THROUGH ITS INSURANCE COMPANY, P.T. ASKRINDO AND THE INSTITUTE FOR THE GUARANTEE OF CREDITS TO COOPERATIVES, GUARANTEES A SUBSTANTIAL PORTION OF BANK LOANS TO SMALL SIZED PROJECTS SPONSORED BY PRIBUMIS THAT ARE FEASIBLE BUT NOT BANKABLE, DUE TO LACK OF SECURITY.

6. PROPOSED LOAN WOULD BE SUED BY BAPINDO FOR THE FINANCING OF DEVELOPMENT PROJECTS DEEMED VIABLE BY BAPINDO. IN ORDER

TO DIVERSIFY ITS PORTFOLIO AND TO CHANNEL PROPOSED BANK LOAN TO LARGE VARIETY OF ECONOMIC ACTIVITIES, BAPINDO WOULD NOT USE MORE THAN 30 PERCENT OF LOAN PROCEEDS FOR FINANCING ANY SINGLE TYPE OF INDUSTRY. BAPINDO HAS ESTIMATED THAT 70 PERCENT OF PROPOSED LOAN AMOUNT WILL BE USED FOR FINANCING MANUFACTURING INDUSTRIES. BALANCE OF 30 PERCENT WILL BE USED FOR TRANSPORTATION LIMITED OFFICIAL USE

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PAGE 02 MANILA 18085 02 OF 03 160808Z

AND RELATED ACTIVITIES WHICH WOULD CONSIST PRIMARILY OF REHABILITATION OF INTER-ISLAND SHIP SERVICE BY

MODERNIZATION OF OLD SHIPS, ACQUISITION OF SECOND-HAND SHIPS, DEVELOPMENT OF DOCKYARDS, ETC., BUT WOULD EXCLUDE REGULAR OCEAN-GOING SHIPS.

7. BAPINDO IS AN IMPORTANT SOURCE OF TERM FINANCE FOR INDUSTRY IN INDONESIA. UNDER INVESTASI PROGRAM, ITS SHARE OF TOTAL OUTSTANDING CREDIT HAS ALMOST DOUBLED FROM 1973 (13 PERCENT) TO 1976 (25 PERCENT). BAPINDO'S SHARE OF INVESTMENT IN MARITIME SECTOR IS EVEN HIGHER THAN ITS INDUSTRIAL APPROVALS. INTEREST IN MARITIME SECTOR STEMS FROM FACT THAT INDONESIA IS AN ARCHIPELAGO. GOVT HAS, THEREFORE, GIVEN TOP PRIORITY TO DEVELOPMENT OF INTER-ISLAND SHIPPING FOR ECONOMIC AND STRATEGIC CONSIDERATIONS. BETWEEN 1973-1976, BAPINDO APPROVED \$70.8 MILLION WORTH OF MARITIME LOANS.

8. TO ENSURE THAT PROCEEDS OF BANK LOANS ARE UTILIZED BY A REASONABLY LARGE NUMBER OF SUB-BORROWERS, A \$4.0 MILLION CEILING ON INDIVIDUAL SUBLOANS IS PROPOSED WITH THE CONDITION THAT AT LEAST 60 PERCENT OF THE LOAN AMOUNT SHOULD BE UTILIZED FOR INDIVIDUAL SUBLOANS NOT EXCEEDING \$2 MILLION EQUIVALENT. BANK ALSO PROPOSING FREE LIMIT OF \$750,000; I.E., SUBLOAN UP TO THIS AMOUNT NEED NOT RECEIVE PRIOR ADB APPROVAL; AGGREGATE SUBLOAN AMOUNT UNDER THIS LIMIT TO NOT EXCEED \$10 MILLION. ALL FREE-LIMIT SUBLOANS IN ANY CALENDAR QUARTER IN EXCESS OF \$1.5 MILLION TOTAL WOULD BE REFERRED TO BANK FOR PRIOR APPROVAL.

9. BAPINDO WAS ESTABLISHED IN 1960 AS A WHOLE GOVERNMENT-LIMITED OFFICIAL USE

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PAGE 03 MANILA 18085 02 OF 03 160808Z

OWNED SUCCESSOR TO BANK INDUSTRIES NEGARA. BAPINDO CHanneled BUDGETARY FUNDS TO GOVERNMENT-SPECIFIED

PROJECTS TILL 1966 WHEN ACTIVITIES CEASED DUE TO RESOURCE CONSTRAINTS. BAPINDO THEREAFTER FUNCTIONED MAINLY AS A COMMERCIAL BANK, ACCEPTING DEPOSITS AND MAKING SHORT-TERM WORKING CAPITAL LOANS AND PROVIDING LIMITED-TERM ASSISTANCE TO PRIVATE AND PUBLIC ENTERPRISES IN INDUSTRY, PLANTATION AND MINING. IN LATE 1960'S, BAPINDO FACED SERIOUS INSTITUTIONAL AND OPERATIONAL DIFFICULTIES; BY 1969, OPERATIONS WERE ALMOST AT A STANDSTILL. IN OCT. 1970, THE CENTRAL BANK DIRECTED BAPINDO TO SUSPEND ITS TERM ASSISTANCE TO NEW CLIENTS. BAN WAS LIFTED IN EARLY 1972.

10. IN 1969-1970, AT GOVT'S REQUEST, WORLD BANK MADE A DETAILED EXAMINATION OF BAPINDO. EXAMINATION SHOWED THAT BAPINDO HAD NO AUTONOMY IN ITS OPERATIONS AND ITS MANAGEMENT WAS POOR. BAPINDO WAS FOUND OVER-STAFFED WITH UNQUALIFIED PEOPLE. ITS BRANCH NETWORK WAS MUCH IN EXCESS OF ITS OPERATIONAL NEEDS. OPERATIONAL PROCEDURES FOR APPRAISAL AND FOLLOW-UP OF PROJECTS WERE NOT ESTABLISHED. FINANCIAL POSITION AND QUALITY OF PORTFOLIO WERE EXTREMELY POOR AND THERE WAS AN ACUTE SHORTAGE OF FUNDS. ALSO, ACCOUNTS OF BAPINDO WERE NOT EXAMINED BY INDEPENDENT PROFESSIONAL AUDITORS.

11. AN INSTITUTION BUILDING PROGRAM WAS INITIATED BY WORLD BANK IN 1971 TO OVERCOME THESE PROBLEMS AND TO MAKE BAPINDO A VIABLE FINANCIAL INTERMEDIARY. IMPROVEMENTS SO FAR INCLUDE, SUBSTANTIAL EQUITY CONTRIBUTION BY GOVT, ENLARGEMENT AND STRENGTHENING OF MANAGEMENT, CLOSING AND/OR DOWNGRADING OF CERTAIN BRANCHES, REDUCTION OF STAFF BY 40 PERCENT MAINLY AT JUNIOR LEVEL, EXTENSIVE TRAINING OF STAFF, A SHIFT TOWARD TERM-FINANCING AS OPPOSED TO COMMERCIAL BANKING, INTRODUCTION OF BASIC PROJECT APPRAISAL AND SUPERVISORY PRO-LIMITED OFFICIAL USE

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PAGE 04 MANILA 18085 02 OF 03 160808Z

PROCEDURES AND EXAMINATION BY PRIVATE INDEPENDENT AUDITORS.

12. NONETHELESS, DURING THE WORLD BANK'S FOURTH LOAN APPRAISAL IN OCTOBER 1976, IT WAS CONCLUDED THAT VARIOUS ORGANIZATIONAL AND OPERATIONAL DEFICIENCIES REMAINED AT BAPINDO. FOR EXAMPLE: (1) QUALITY OF PORTFOLIO CONTINUED TO BE UNSATISFACTORY; (2) DEBT-SERVICING

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PAGE 01 MANILA 18085 03 OF 03 160814Z

ACTION TRSE-00

INFO OCT-01 EA-10 ISO-00 NEA-10 IO-13 H-01 L-03 PRS-01

PA-01 AID-05 CIAE-00 COME-00 EB-08 FRB-03 INR-07

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LIMITED OFFICIAL USE SECTION 3 OF 3 MANILA 18085

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BY SOME STATE ENTERPRISES, IN PARTICULAR, WAS VERY POOR;
(3) LOAN COLLECTION EFFORTS BY GOVT AND BAPINDO WERE
INADEQUATE; AND (4) PROVISION FOR DOUBTFUL ACCOUNTS
WERE NOT SUFFICIENT. BRANCH NETWORK STILL DID NOT CORRES-
POND TO INSTITUTIONAL NEEDS. ROLE OF HEAD OFFICE AND
BRANCH OFFICER NOT ORGANIZED WITH RESULTANT DUPLICATION
OF WORK. LOAN PROCESSING IN BAPINDO WAS EXTREMELY
SLOW. THERE WAS ALSO INADEQUATE STAFF FOR ECONOMIC AND
MARKET EVALUATION OF PROJECTS. ADMINISTRATION EXPENSES
WERE RELATIVELY HIGH AND OPERATIONS OF BAPINDO DID NOT
SHOW SUFFICIENT EMPHASIS ON FINANCING OF MEDIUM-SIZED
PROJECTS AND THERE WAS TENDENCY TO FINANCE LARGE PROJECTS.

13. IN APRIL 1977, AS PART OF FOURTH WORLD BANK LOAN,
BAPINDO AGREED TO IMPLEMENT A PROGRAM OF ACTION (POA)
TO ALLEVIATE ABOVE-MENTIONED WEAKNESSES. POA IS GROUPED
IN TWO PARTS - PART A, DEALING MAINLY WITH UNSATISFACTORY
PORTFOLIO SITUATION, WAS TO BE (AND HAS BEEN) IMPE-
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PAGE 02 MANILA 18085 03 OF 03 160814Z

MENTED PRIOR TO SIGNING OF WORLD BANK LOAN, WHILE
PART B DEALS MAINLY WITH INSTITUTIONAL PROBLEMS.

14. ADB CONTRIBUTION TO INSTITUTION BUILDING WILL CENTER
AROUND STREAMLINING ORGANIZATIONAL STRUCTURE, MORE INTENSIVE
SUPERVISION, PORTFOLIO AUDIT, BETTER CONTROL ON LOAN

PROCESSING PROCEDURES, AND DEVELOPMENT OF MORE SYSTEMATIC TRAINING PROGRAM FOR STAFF. IT IS EXPECTED THAT MEASURES INTRODUCED BY WORLD BANK AND ADB WOULD LEAD TO SNGNIFICANT IMPROVEMENTS IN BAPINDO.

15. BAPINDO'S FINANCIAL POSITION IS SATISFACTORY AS MEASURED BY ITS CURRENT RATION, DEBT-SERVICE COVERAGE AND DEBT/EQUITY RATION, BUT IT IS OVERSHADOWED BY POOR QUALITY OF ITS PORTFOLIO. PROFITS OF BAPINDO HAVE BEEN LOW DUE TO DEFAULTS BY SUB-BORROWERS IN INTEREST PAYMENTS, HIGH ADMINISTRATIVE EXPENSES AND EXCESSIVE WRITING OFF OF BAD DEBTS. HOWEVER, PROFITABILITY IS EXPECTED TO IMPROVE IN FUTURE YEARS AS IFI RECOMMENDATION TAKES EFFECT.

16. BAPINDO WILL SATISFY BANK THAT PROCUREMENT PROCEDURES ADOPTED BY INDIVIDUAL SUB-BORROWERS ARE APPROPRIATE. FURTHERMORE, BAPINDO WILL ALSO ENSURE THAT GOODS AND SERVICES TO BE FINANCED OUT OF PROCEEDS OF PROPOSED LOAN SHALL BE PURCHASED AT REASONABLE PRICES. BANK WOULD ENCOURAGE BAPINDO TO ASK SUB-BORROWERS TO ADOPT INTERNATIONAL COMPETITIVE BIDDING WHERE APPROPRIATE.

17. INDUSTRIAL SECTOR HAS BEEN MOST RAPIDLY GROWING SECTOR IN INDONESIA AND, ACCORDING TO LONG-TERM DEVELOPMENT OBJECTIVES OF GOI, IT IS EXPECTED TO BECOME MOST LIMITED OFFICIAL USE

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PAGE 03 MANILA 18085 03 OF 03 160814Z

IMPORTANT SECTOR IN COUNTRY BY LATE 1980'S. BAPINDO IS LARGEST DEVELOPMENT FINANCE INSTITUTION IN INDONESIA AND HAS BEEN ASSIGNED LEADING ROLE BY GOI IN CHANNELING ASSISTANCE FOR INDUSTRIAL DEVELOPMENT OF COUNTRY, HOWEVER, SINCE ITS ESTABLISHMENT, BAPINDO HAS BEEN BESET WITH INSTITUTIONAL, OPERATIONAL, AND FINANCIAL PROBLEMS.

18. USADB COMMENTS: THIS WOULD BE FIRST ADB LOAN TO INDONESIA FOR A DEVELOPMENT FINANCE INSTITUTION. STAFF WAS QUERIED ON ADB'S RATIONALE FOR MAKING LOAN TO AN INSTITUTION THAT IS ALREADY RECEIVING SUBSTANTIAL WORLD BANK ASSISTANCE (ALMOST \$190 MILLION IF LOAN SCHEDULED MID-1978 INCLUDED) AND WHERE ADB NON-FINANCIAL CONTRIBUTION APPEARED MINIMAL. RESPONSE WAS THAT ADB WAS LOOKING FOR PROJECT TO ASSIST MEDIUM-SIZE INDUSTRY IN INDONESIA AND THAT BAPINDO WAS LOGICAL CHOICE FOR EXECUTING AGENCY. STAFF ALSO CITED JOINT FINANCING VENTURES (FOR DFIS) BETWEEN WORLD BANK AND ADB IN PAKISTAN, SRI LANKA, THAILAND, PHILIPPINES, AND KOREA. IT WAS ALSO FELT THAT ADB COULD MAKE A SUBSTANTIAL CONTRIBUTION TO BAPINDO'S INSTITUTIONAL STRENGTHENING. STAFF HAD ALSO NOT SEEN ANY RECENT EXAMPLES OF GOVT INTERFERENCE IN

BAPINDO'S SUB-PROJECT SELECTIONS. WORLD BANK AND ADB WILL WORK CLOSELY WITH EACH OTHER AND EXPECT SUBSTANTIAL IMPROVEMENT IN OPERATIONS OF BAPINDO. SINCE AN INCREASING PROPORTION OF ENTERPRISES ARE EXPECTED BE AWAY FROM EXISTING URBAN CENTERS AND IN LESS DEVELOPED PARTS OF THE COUNTRY IT IS EXPECTED THAT THE PROJECT WILL LEAD TO INCREASED RURAL EMPLOYMENT, SMOOTHEN OUT SEASONAL UNEMPLOYMENT AND/OR UNDEREMPLOYMENT, HAVE BENEFICIAL IMPACT ON COUNTRYSIDE AND CONTRIBUTE TO BALANCED REGIONAL DEVELOPMENT. PROJECT APPEARS ECONOMICALLY AND TECHNICALLY ADEQUATE. USADB THEREFORE RECOMMENDS FAVORABLE NAC ACTION. NONE-THELESS, DUE TO THE SLOW PACE OF IMPROVEMENT IN EXECUTING AGENCY, ALSO RECOMMEND U.S. EXECUTIVE DIRECTOR STATE AT BOARD THAT ANY FUTURE ADB INVOLVEMENT IN BAPINDO SHOULD BE CONSIDERED IN LIGHT OF EXPECTED IMPROVEMENTS LIMITED OFFICIAL USE

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PAGE 04 MANILA 18085 03 OF 03 160814Z

IN PERFORMANCE OF EXECUTING AGENCY.

19. REQUEST AMEMBASSY JAKARTA COMMENTS FOR NAC AGENCIES, INFO USADB MANILA, PURSUANT TO STATE 119795 DATED 3 JULY 1972. EDMOND

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Message Attributes

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Sent Date: 16-Nov-1977 12:00:00 am
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Disposition Approved on Date:
Disposition Case Number: n/a
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Locator: TEXT ON-LINE, ON MICROFILM
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